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New York

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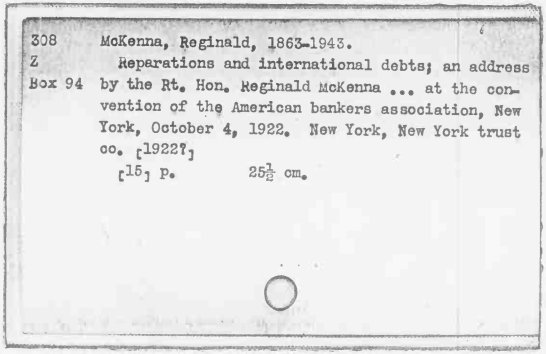

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REPARATIONS

and

INTERNATIONAL DEBTS

An Address by the

Right Honorable Reginald McKenna

Chairman of the London Joint City and Midland Bank, Ltd.

At the Convention of the

American Bankers Association

New York, October 4, 1922

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NOTE

OF all the subjects discussed at the recent American Bankers Association Convention in New York, the problems involved in the international debt received and were entitled to receive most attention. To this discussion several important contributions were made by American bankers and by the Right Hon. Reginald McKenna, Chairman of the London Joint City & Midland Bank, Ltd.

Mr. McKenna's speech is here reprinted and recommended for perusal by all who would enlarge their understanding of the economic and financial aspects of the problems involved in the international debts, in which the German reparations are an essential factor.

That no other nation than Great Britain can be expected to discharge its international debt, and that it would be undesirable for us as well as other nations that payment of the international debt should be undertaken are the outstanding features of Mr. McKenna's paper.

Two sentences of Mr. McKenna's inevitably remain in the reader's mind. One of these closes his discussion of what happened in Germany as a result of the payment of the French indemnity in 1871: "The comparative prosperity in France and depression in Germany are remarkable and give color to the story that Bismarck, in commenting upon the state of the two countries, declared that the next time he defeated France he would insist on paying an indemnity."

And again when Mr. McKenna, referring to the large amount borrowed by Americans abroad prior to the war, said that while our exportable surplus sufficed to pay the interest, "repayment of the capital, however, would have been beyond even your capacity for a very long period had it not been for the opportunity afforded by the war."

These two statements serve to epitomize on the one hand the disastrous results that would follow repayment of the international debt, even if it were practicable; and on the other they indicate the impossibility of adjusting the debt to us upon the conditions and under the limitations imposed by Congress when it created the Allied Debt Commission to deal with this problem.

HARVEY D. GIBSON,
President.

Reparations and International Debts

From an Address by The Right Hon. R. McKenna, Chairman of the London Joint City and Midland Bank, Limited

When I received the honor of your invitation which I greatly appreciated, I must confess I had many misgivings. I knew it would not be a light task to address an audience whose collective importance in the world of finance is unrivalled. I remembered, however, the cordial friendship which has always existed between American and British bankers, and as I realized that your invitation was a further evidence of this friendship my hesitation gave way and I gladly decided to come.

Let me begin with an explanation of my choice of subject. I thought at first that some professional topic should be selected, but I soon came across a serious difficulty. There is a much greater difference between the law and practice of banking in America and England than is generally supposed, and I felt that I should be liable to be misunderstood unless this difference were constantly borne in mind. This very meeting will illustrate the point.

I understand there are over thirty thousand separate banks in the United States, a large number of which are represented here. In the whole of Great Britain we have only thirty-nine. But with us the branch system is so highly developed that these few banks have no less than 9,650 branches, of which 6,800 belong to five banks alone.

Differences Between British and American Banking

The main distinction is that our banks are regarded by the legislature as ordinary corporations or companies, while yours are subject to special legislation in regard to nearly all their activities. You have a limit prescribed to the amount of a loan to any one customer. Certain loans are prohibited and others are restricted. Your investments are regulated. You are subject to limitations in incurring contingent liabilities and you are bound to maintain minimum cash reserves. We have none of these restrictions. Alone amongst deposit banking countries the United States protects depositors, some of the states going so far as to prescribe a system of guarantee.

Britain's Central Bank System

We differ also in our central bank policy. You have adopted the Federal Reserve System under which there are twelve Federal Reserve Banks in twelve districts. In England we have a single central bank of issue, a joint stock corporation which deals with private customers as well as with the Government and the banks. Your Federal Reserve notes are issued against gold and self-liquidating commercial paper. Our Bank of England notes are issued against gold only, with a fiduciary issue of £18,450,000.

The principles of sound banking are the same everywhere, but our countries diverge in law and practice. This is natural: British social and political conditions differ so much from yours that the same banking system could hardly be appropriate to both. Perhaps we have each something to learn from the other, but I am sure any hasty attempt to establish a common procedure in the two countries would be unwise. As our development has progressed each nation has adapted itself to its environment, and such changes as we may make in the future must conform to the habits and traditions of our peoples.

With these thoughts in mind I found it very difficult to select a technical banking subject for discussion today. However careful I might be I felt that, unless accompanied by much tedious explanation, my language, associated with ideas related to English practice, would be liable to be misunderstood by you whose associated ideas are so different. I resolved therefore to pass over professional banking topics and to look for a subject of general interest to the business community. What should this be?

Reparations and International Debts

In their report to the Reparation Commission the Bankers' Committee which sat early this summer in Paris laid stress upon the need to resume normal trade conditions between countries and to stabilize exchanges, and they came to the conclusion that neither of these aims could be accomplished without a definite settlement of the reparation and other international debts. Here then it seemed to me was a subject for my address.

There will be general agreement that there is no matter of more deep concern to the world's trade at the present time than reparation payments and international debts, and I trust therefore you will not deem it out of place that I have chosen this subject for discussion today.

There are two preliminary observations which I must make. The first is that I speak as a banker expressing my personal views. I have nothing to do with politics and I do not appear here in any representative character. I approach the question solely from the economic point of view and my endeavor is to determine so far as I can the limit of the debtors' capacity to pay, and the effect of payment upon the world's trade. Our duty is to satisfy ourselves on the financial possibilities of the case. It is not what the debtors may justly be called upon to pay, but what they are able to pay, which we as business men, anxious to discover the conditions upon which trade prosperity is founded, must consider with the most careful attention.

My second observation is to meet a possible criticism. How can I, a member of a nation which is one of the debtors of the United States, speak freely to an American audience upon international indebtedness? The primary and essential duty of a debtor is to discharge his liability, and, until this is done, all observations on the origin of the debt and on the economic consequences of international payments are liable to be viewed with suspicion. A creditor may, if he like, open up questions of that kind, but a debtor should admit his obligation without further discussion. I recognize that these are objections which I must answer and I believe that I can do so conclusively.

In the course of my argument I shall show that England has the ability to pay, and, once that is established, I can unhesitatingly assert her determination to honor her bond in full. I believe I am justified in asking you to treat England's debt to the United States as certain to be provided for, and, if this be conceded, we shall be free to consider the question of the remaining international debts as one in which America and England are equally concerned and in which both have the same interest as creditors.

Magnitude of the War Debts

First, let us look at the magnitude of these international debts. The greatest of all is that of Germany for reparations, a debt of which the United States declined to receive any shares. The amount was not defined by the Treaty of Versailles, but subsequently by the London Ultimatum it was put at 32 billion dollars, at which amount it stands nominally today. Of the remaining debts the liability of France to the United States and Great Britain is 6½ billion dollars, and of Italy to the same two countries 4½ billion dollars. Russia owes these countries 3½ billion dollars and a further 1 billion dollars to France. These are the principal debts; the others are all comparatively small in amount. Of the creditors of the European Continental Governments, England is the greatest.

We have no record in history of international claims of this magnitude. The indemnity exacted by Germany from France under the Treaty of Frankfort in 1871, in round figures 1 billion dollars, created the largest debt between Governments ever known until the recent war, and is the only precedent we have of a considerable international payment. It is of interest to recall how the liability was discharged. Payment of 150 million dollars was made in gold and silver coin and in German banknotes and currency collected in France and the balance in foreign bills, chiefly German currency bills.

How France Paid the 1871 Indemnity

The precise form in which the payment was made is however comparatively unimportant. For our present purpose the significant question is how France procured the means of payment. She was bound to acquire German marks or foreign currency exchangeable for marks, and to do so she had either to find German or other foreign buyers for such things as she had to sell or to obtain foreign subscriptions to her loans. Very considerable sales were made of foreign securities owned by French nationals, the French loans were largely subscribed externally, and the export of French goods was so much increased that an average excess of imports of 65 million dollars a year in the four years 1868-1871 was converted into an average excess of exports of 46 million dollars a year in the four subsequent years. By September, 1873, the whole indemnity was paid, and although France remained to be liable for the loans she had issued, she was clear of any direct debt to the German Government, and indeed of all foreign debt payable in any but her own currency.

Here we have an example of a very considerable international debt rapidly paid off without any serious disorganization of the world's trade. Now what were the conditions which made this possible? The war had been short, and the same amount of indemnity was well within the capacity of France to pay. Her nationals held large blocks of foreign securities, which were realizable in foreign markets; her credit was good, which enabled her to obtain foreign subscriptions to her loans; and in her effort to increase her exports she was not hampered by high tariffs.

France's Resources in Accumulated Wealth

She was driven off the gold standard and, although there was some decline in the value of the franc, the depreciation never exceeded 5 per cent. and, taking the whole period through, amounted to barely more than 1 per cent. But of the several factors in the French ability to pay the most important lay in her accumulated reserve of wealth, the foreign securities owned by her nationals.

It is interesting to note the industrial condition of France at that time. Employment was extremely active and production was on a great scale. She had to meet her external liabilities, which compelled her to increase her sales in foreign markets, and she did so notwithstanding the competition of other nations. The improved standard of efficiency in production which was thereby forced upon her endured long after the period of the indemnity. In Germany, on the other hand, there was a very different experience. The receipt of a large amount of gold and silver had, with other causes then in operation, a serious effect upon German internal prices, which rose rapidly.

Effects Upon Germany of French Payments

In 1872 there was a brief trade and financial boom, followed in the ensuing year by a crisis which was the beginning of a period of depression. It would not be correct to say that the trade conditions in Germany were entirely due to the payment of the French indemnity, but undoubtedly it was a contributory cause of material importance. The

comparative prosperity in France and depression in Germany are remarkable and give color to the story that Bismarck, in commenting upon the state of the two countries, declared that the next time he defeated France he would insist on paying an indemnity.

Such is the only precedent we have for the payment of a great international debt. The figures we have to deal with today are on a far larger scale than the indemnity exacted from France fifty years ago, but the problem in all essential particulars is the same. We have to discover the capacity of the debtors to pay and to consider the consequences of payment. As the indemnity demanded from Germany is much the greatest of the debts and is the one most urgently in need of satisfactory settlement I place it in the front of our discussion

Germany's Capacity to Pay Reparations

The first question is, what is Germany's capacity to pay? You are perhaps expecting that I am about to give you an inventory of Germany's natural resources and an estimate of her productive power. All this has been done many times and much industry has been displayed in the inquiry. I have no doubt that the experts who advised the signatories of the Treaty of Versailles that Germany could pay 120 billion dollars had made many careful calculations of this kind. But what we have to investigate is not Germany's capacity to produce wealth, but her capacity to pay foreign debt.

I cannot help thinking that we have here the source of the error into which the Versailles experts seem to have fallen. Nobody has ever doubted Germany's immense power to produce, but production by itself is not enough. She must find a market for her exports, and the problem thus becomes one of determining the possible extension of German export trade. Nor is this the end. We must remember that an increase in her exports will only provide funds for reparations if there is no corresponding increase in imports. Payment for her indispensable imports must be the first charge upon the proceeds of her foreign sales, and it is only the balance, the exportable surplus, which is available for reparations.

"Exportable Surplus" Analyzed

In speaking of a nation's exportable surplus we must not forget that other factors may contribute to it besides the balance of exports over imports. Interest received from foreign investments and payment for external services, such as shipping, may be contributory factors. Before the war Germany possessed a very considerable exportable surplus derived from all three sources, but mainly from the interest on her foreign investments which were probably worth not less than 5½ billion dollars. As regards the surplus from the sale of her products and payment for services it is safe to say that it never exceeded 100 million dollars a year. But what is her position today?

Most of her foreign investments have gone. Some were sold during the war, others have been seized as enemy property by the Governments of the Allied and Associated Powers, and most of what remain have lost their value, as in the case of the Russian investments. Her shipping has been largely confiscated, and she has been deprived of some of her most productive areas—Alsace-Lorraine, the Saar Basin, and the Polish provinces. All the sources whence an exportable surplus might have been drawn have been greatly impaired if not wholly destroyed.

Impossible For Germany to Pay Out of Exports

At no time was Germany's exportable surplus sufficient to enable her to make the annual payments demanded under the London ultimatum; it is entirely out of the question that she could do so today.

But let us get a little nearer to the problem of Germany's present capacity to pay from the surplus sale of her production. According to a recent statement by the Chancellor of the Exchequer in the House of Commons, she has paid money and delivered property altogether to the value of about two billion dollars. Of this amount 1,645 million dollars represented the value of ships, coal, other payments in kind, property in ceded territories and local payments to Armies of Occupation. The amount in cash has been only 375 million dollars. And yet, with this comparatively small cash payment, observe what has happened.

The mark has declined to less than one-seventieth of the value it had when the obligation to pay was imposed upon Germany by the Treaty of Versailles. The means of payment has been found by the sale of marks. After this experience it is difficult to believe that Germany has any surplus at the present time from the export of her products.

There is a further consideration in support of this conclusion. It is beyond question that in the last three years Germany has made every effort to develop her external trade. The German workman, whose industry and efficiency are generally admitted, has been fully employed and the factories have been actively at work all over the country.

German Competition Already Causes Complaint

The decline in the mark, which at every stage has been much greater in the external than in the internal value, has afforded a very considerable advantage to the German exporter, so much so indeed that there is hardly anywhere a manufacturer, producing goods for export, who does not complain of German competition. Nevertheless, the German trade figures show that the exports, long after the immediate deficiency in essential foreign commodities due to the war was made good, are still barely equal to the imports. The conclusion seems irresistible that Germany has no present capacity to obtain a surplus from the export of goods.

I am not sanguine enough to believe that those who think they can extract from Germany enough money to enable them to meet the internal liabilities, which they themselves have incurred in restoring devastated areas, will be satisfied with the statement I have just made.

Effect of Enforcing German Payments

At the recent Reparation Conference of the Allied Powers held in London proposals were made of punitive measures to be taken with the object of compelling Germany to make immediate cash payments, a policy which could only have been advanced under the conviction that Germany really could pay. For my part I do not believe that it is within her power to do so, but let us suppose for a moment that she can. We have then to consider what the effect of this enforced payment would be upon international trade, and whether it would be to the advantage either of Germany's creditors as a whole or of the rest of the world.

If Germany could pay what is demanded of her, the only method of obtaining the money would be by increasing her exports. Now what are these exports to be? She is essentially a manufacturing nation. Her foreign sale of raw materials is comparatively small. On balance she is obliged to import food, and in consequence of the loss of a large part of her mineral lands she is compelled to import both iron ore and coal for the supply of her factories and furnaces. An increased exportable surplus could only be obtained by extending her sale of manufactured goods. To do this in the teeth of the competition of other manufacturing nations she must work longer hours for less wages, she must cut profits, she must reduce her imports to the indispensable minimum.

But her competitors will not consent to stand idle while they lose their trade. They

will find themselves faced with growing unemployment and heavy trade losses. So far as German goods seek to invade their own domestic markets they may endeavor to exclude them by tariffs, but in order to retain their hold on neutral markets they, too, will be compelled to reduce wages and cut profits. And thus Germany's effort to extend her foreign trade must be confronted with the opposition of the whole manufacturing interest of the rest of the world, and could only be successfully countered by a general lowering of the standard of life.

I know it is frequently alleged that the collapse of the mark, with the accompanying disorganization of the world's trade, might have been avoided if the German Government had acted with firmness and good faith. It is said that Germany has intentionally depreciated her currency in order to induce her creditors to abandon their claims. We are told that her people are not adequately taxed, and that if they were subject to the burdens borne in some other countries, the Government would be able to meet its liabilities.

Additional Taxation Would Not Help

It is certainly true that in my own country far heavier taxation is levied than in Germany, but I am inclined to think we are overtaxed and that overtaxation, so far from fostering, cannot fail to depress national production. But whether I am right or wrong in that opinion I fail to see how additional taxation can stimulate foreign trade and provide a large exportable surplus. The taxes would be paid in marks, and, whether the marks are derived from avowed taxation or from concealed taxation through the use of the printing press, they are in neither case a currency which would be accepted in discharge of foreign liability.

In the actual condition of Germany a foreign sale of marks is an inevitable accompaniment of the payment of reparations. Except by such sale there does not appear to be any practicable method for the Government to obtain the necessary foreign currency other than by exacting it from exporters as a condition of their receiving an export license. But the exporter, who often has external obligations of his own to meet, does not want marks but dollars or pounds sterling, as the case may be, and forthwith sells the marks paid him by the Government for the currency he needs. If we add to this regular sale in the course of business the further sale by Germans who mistrust the stability of their own currency, we have a sufficient explanation of the stupendous drop in the value of German money.

How to Realize On German Investments

Let me come back now to the question of what Germany can pay. Certainly she can pay something, though not in the form or under the conditions it is now sought to impose upon her. Many Germans possess foreign assets, whether investments or balances in foreign banks, and it would be a perfectly practicable proceeding for them to sell these assets to the German Government, who in turn could hand them over to the Reparation Commission. But it is an essential condition of such a transaction that the owners of the foreign assets should be willing to sell them; no Government in the present situation of Germany could force a compulsory sale. How then could this consent be obtained?

I have no doubt that if these assets could be sold for an assured profit the holders would be willing to dispose of them. It must be remembered that to a considerable extent they are the proceeds of sales of marks which have been flung by Germans on the foreign market under the well-founded apprehension that the pressure of reparation payments would rapidly depreciate their value. Relieve this pressure and the mark would immediately improve. It has still a far greater value in Germany than it has outside, and the German holders of foreign assets would have a clear advantage in selling them for marks to their Government.

German Foreign Investments Only a Billion Dollars

It is impossible to give any precise estimate of the total value of these assets, but I believe it would be safe to put them at not less than a billion dollars. Whatever the amount may be, however, Germany could pay it, provided the fall in the mark was arrested. More than that I do not think she has the ability to find, at any rate for some years, and it would be a condition of this payment that no more should be demanded of her for a long time to come. I believe that, looking merely at the amount to be received, the creditors would gain by abandoning the attempt to obtain other money payments for a period of at least three years, and I am quite sure the world as a whole would be an immense gainer in the general stabilization of exchanges which would ensue upon an arrest of the fall in the mark.

Before I leave this part of my subject there is one observation I should like to make. I have no wish to minimize the just claims of the Allies against Germany, and I recognize the serious political difficulties which stand in the way of their abatement. But no solution of the reparation is possible unless political considerations are subordinated to economic facts. What Germany can pay may not be a simple question, but it is a question capable of being answered. Unfortunately the answer runs counter to popular hopes, popular passions, and, more formidable still a popular sense of natural justice which prescribes that the defeated enemy who planned the War should make good the damage suffered by the victors. And so no authoritative answer is given while Europe slides into ruin.

German Limitations Common to All Countries

I have dealt at length with the reparation problem in an endeavor to show that a nation, except in so far as it has an exportable surplus, can only pay foreign debt out of the wealth it has accumulated outside its own country. If we pass now to the other international debts we have to recognize that the general argument is equally applicable to them all. Have the debtors an exportable surplus and what are their foreign assets?

With regard to the latter question the only debtor possessing any large accumulation of such assets is England. Notwithstanding her immense sale of securities to the United States the second and third years of the war, a sale which largely furnished the means of paying for the goods of all kinds bought by the Allies, England still owns sufficient foreign securities to cover her debt to the United States two or three times over. But neither France nor Italy has similar reserves of wealth, and I doubt whether either of them has sufficient to meet more than a trifling part of their foreign debt.

Only Small Payments Out of Export Surplus

There remains to be considered their exportable surplus in the ordinary way of trade. I shall speak later of the circumstances in which an exportable surplus from production usually arises, and I shall give my reasons for thinking that nothing more than comparatively small annual payments can ever be made in this way. But it will be more convenient now to deal with an individual debt and I will ask you to consider the particular case of the debt from France to England, which I can speak about with more freedom as it is a debt in regard to which my own country is the creditor. We shall get a clearer view of it if we examine the circumstances in which it was incurred.

During the War France developed an immense demand for goods of foreign production. As an increasing proportion of her manpower became engaged in her army, her capacity to supply herself was progressively reduced. She had no abundance of foreign securities with which to pay for her requirements and she could obtain the war materials indispensable for the maintenance of the fight

in no other way than by borowing the money to pay for them.

Before the United States came into the War France had borrowed one billion dollars from the British Government, and this amount was subsequently increased to over 2½ billion dollars. The price of the goods bought by France was naturally high. Commodities produced to meet an urgent war need can never be cheap. But France was obliged to have the goods, whatever the price, and a great stimulus was given to American and British trade.

How Could France Pay Her Debt?

Let us now reverse the process and imagine France paying off this debt. She could only do so by producing goods and exporting them in very large quantities, far in excess of normal trade demands. If the general trade organization of the world permitted of the absorption of this additional French output, I have no doubt that her industry would be capable of the effort necessary to enable her to pay interest and sinking fund on her debt. But would there be any willingness to receive the goods? Neither England nor any other country is prepared today to pay for and consume goods on an exceptional scale. The immense demand created by the War has no parallel in peace. And yet how is France to pay unless an exceptional demand exists?

The truth is that her debt is far too great in relation to ordinary international trade possibilities. It was incurred by the purchase of goods required in war and bought at war prices. It could only be discharged by the transmission of goods, not wanted in peace, and sold at no less high prices. We became accustomed in war to talk in billions. Our language was suited to the circumstances of the time, but, if we carry our minds back to 1914 and return to the ideas appropriate to peace conditions, we shall recognize at once that France has no trade surplus or reserves of accumulated and exportable wealth to enable her to meet her present external liabilities.

There are of course conceivable, though I trust improbable, conditions in which the French Debt to us might be repaid. If we were at war and the call upon our men to line the trenches was such that many of our mines and factories had to close down; and if France were at peace and at liberty to increase her output to the utmost of her capacity she might pour upon our shores war material and stores equal to the whole amount of her debt to us. But in what part of the globe is there a demand for this additional output in time of peace? The mere endeavor to extend her foreign sales to the necessary degree would disorganize the trade of the world. We have seen the painful effect of an enforced competition by Germany; we should experience precisely the same results from a similar effort by France.

The inevitable conclusion is that these international debts are far too great for the capacity of any of the debtor countries except England. She alone in her accumulated foreign investments has adequate resources with which to discharge her liability to the United States.

French Resources Unequal to Obligations

Of the others, France has the greatest resources, but they are, I believe, quite insufficient to meet her obligations. The whole subject requires a rational reconsideration by the creditors, who must keep steadily in view the immediate effect of the payment of these debts on the general trade of the world. The creditor countries will obtain greater advantage from trade prosperity, which will insure full employment in their factories and workshops, than they can ever receive from the precarious payment of these debts.

In the last two years we have had experience of the effect upon foreign trade of tumbling exchanges and broken-down credit, and, though the consequences may be more serious in England than in the United States, where foreign trade is comparatively only a small part of the total trade, they are still grave enough in the latter country also to warrant the fullest and most careful consideration.

Real Meaning of an "Exportable Surplus."

It may be objected that my argument appears to lead to the unpalatable conclusion that no nation, unless it has accumulated resources in the form of foreign investments, can discharge external obligations to anything more than a comparatively small amount. This is an objection which goes to the very root of the question of international loans and forces us to a consideration of the real meaning of an exportable surplus. I cannot do more than touch upon it briefly now without stretching your patience beyond the limit of extreme good nature.

It seems to me that the most compact form in which I can present the case is by calling your attention to the experience of England as a creditor country. For over two centuries British capital has been lent to other countries. Year by year England produced more than she either consumed herself or could exchange for the products of other nations, and she could not obtain a market for the surplus unless she gave the purchaser a long credit. Foreign loans and foreign issues of all kinds were taken up in England and the proceeds were spent in paying for the surplus production. British factories and workshops were kept in good employment, but it was a condition of their prosperity that a part of their output should be disposed of in this way.

Taking the aggregate of the transactions British creditors have received a good return on their investment, but the ability of the debtors to pay has been dependent, speaking generally, on the development of their country being fostered by the receipt of further loans. If we take the whole field of British foreign investment we shall find that every year England has returned in loans more than she received in interest, and the balance of the world's indebtedness to her has steadily been growing.

From this view of loans made to foreign countries they might seem at first sight to be somewhat unremunerative. If the creditor has to go on lending in order to be paid the interest on previous loans, a bad debt would appear to be the only possible end to the business. But this is by no means the case. While this continuous lending has been true in the past in the aggregate of foreign loans, it is not necessarily true in any individual instance, nor does it follow that it will always be true of the loans as a whole.

In our experience as bankers it is not uncommon to see loans to corporations and firms justifiably increasing in amounts. The borrower may show by the growth of his business and expanding turnover that such advances are thoroughly warranted, and, in spite of his greater total of indebtedness, his credit may be improving and his balance-sheet may disclose an increasing surplus. What is true of an individual or corporation may be true of a country, but on a larger scale and viewed over a much more extended period of time. The life of an individual, or even of the most successful company, is as nothing compared with the life of a nation.

United States as an Example

Take the case of your own country. The United States has been the greatest external borrower in history. You required foreign capital for your internal development and you took from England alone not less than 3 billion dollars. It is estimated that at the time of the outbreak of the war your external debt had become stationary in amount, and that your exportable surplus of commodities sufficed to pay the whole of the interest. Repayment of the capital, however, would have been beyond even your capacity for a very long period had it not been for the opportunity afforded by the war. As

you know, there arose then an inexhaustible demand in Europe for American goods, which led to an immense increase in your exports. Payment for these exports was largely made out of the proceeds of the sale of the stocks and bonds held in England, and thus a capital liability which had been growing for over two centuries was almost entirely discharged in a few years.

We see, then, that a debtor nation may in certain circumstances pay off its foreign debt with remarkable ease and rapidity. The indispensable condition for such rapid repayment is that there should be an extraordinary demand for its goods, a demand which is a natural accompaniment of war but does not exist in peace. I cannot help thinking that there has been a general, though very natural, misunderstanding of the conditions under which international payments are made. In its present magnitude the subject is new.

Mistaken Opinions Causing Grave Disasters

In the past we have been accustomed only to the discharge of comparatively small liabilities between nations which has been effected partly by the remittance of gold, and partly by an extension of export trade facilitated by a fall in the exchange of the debtor country, and it is not easy for us now to free ourselves from the ideals we have formed in the course of our past experience. Mistaken opinions on these economic questions are not surprising, but they are causing grave disasters throughout the world. It is not many years ago—it is well within my own recollection—that a want of understanding of sound principles of banking led to repeated financial crises which were then believed to be inevitable. As they usually happened at intervals of ten or eleven years, many serious persons attributed them to the variations which occur in the spots on the sun. These spots may affect the weather and, through the weather, the harvest, but a wider knowledge of banking and of currency requirements has taught us how to escape their malign influence on credit.

A better understanding of international trade and of the possible limits of international payments will quickly enable us to find a remedy for the evils which now distract us. The public on both sides of the Atlantic are beginning to take a more rational view than was possible three years ago, and if the leaders of opinion direct our footsteps along the right path I believe the world is now prepared to follow it.

Mr. McKenna's Conclusions

To sum up: the conclusion to which I am driven is that Germany can only pay now whatever she may have in foreign balances, together with such amount as she can realize by the sale of her remaining foreign securities; that this payment is only possible if all other demands are postponed for a definite period long enough to insure the stabilization of the mark; and that future demands at the expiration of this period must be limited to the annual amount of Germany's exportable surplus at that time. Further, that England has the capacity to pay to the United States interest and sinking fund on her debt, but that the other debtors are none of them in a position to meet more than a small part of their external liabilities, and in the existing condition of Europe a definite postponement of any payment by them is desirable in the interests of all parties.

The actual amount which the other debtors could ultimately pay should, as in the case of Germany, be ascertained by inquiry into their exportable surplus at a full and frank conference between creditors and debtors.

It remains only for me now to thank you for the patience with which you have heard me. I have strictly confined myself to a consideration of the economic aspect of Reparations and International Debts, how they are payable, the general capacity of a debtor country to pay, and the effect of payment.

If I have become convinced that an attempt to enforce payment beyond the debtor's ability is injurious to the international trade of the whole world, lowers wages, reduces profits, and is a direct cause of unemployment, the conclusion is founded solely on economic grounds and is uninfluenced by any political considerations or any regard to the moral obligations of the debtors.

I know very well that there are other considerations affecting these debts, but these are matters of statecraft to be determined by the rulers of the creditor countries according to their view of wise policy, which covers many interests besides those of trade and finance. The fact that a debtor cannot pay does not of itself discharge the obligation. The debt may become the subject of negotiation and bargain by which if the debtor obtains relief, the creditor may still recover some advantage to which he may be justly entitled. But I conceive it to be the duty of bankers to help so far as they can in forming a sound public opinion upon the financial and commercial aspects of these international debts, and it is in pursuance of this duty that I have ventured to make these observations today.

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